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# 300 PROGRAM COSTS

## ALLOWABLE AND UNALLOWABLE COSTS (OMB CIRCULAR A-87)

The Office of Management and Budget (OMB) Circular A-87 provides uniform rules for determining allowable costs of federal grants and contracts with state and local governments. The basic intent of the circular is that federally assisted programs bear their fair share of costs.

### ALLOWABLE COSTS

The OMB Circular A-87 provides for uniform standards of allowability, uniform standards of allocation, identity of the full costs to federal programs, assurance that federal programs bear their fair share of costs, and simplification of intergovernmental relations.

To charge to federal programs, costs must be:

- a. necessary and reasonable to the performance and administration of the project;
- b. allocated equitably to the federal award, including nonfederal activities;
- c. authorized or not prohibited by state or local laws or regulations;
- d. in accordance with limitations and exclusions in OMB Circular A-87 regarding specific types of costs and amounts;
- e. consistently treated as nonfederal costs are treated;
- f. charged either as a direct cost or an indirect cost, but not both;
- g. recorded and reported in conformance with Generally Accepted Accounting Principles;
- h. excluded from costs used to meet matching requirements for another federal award, except where specifically allowed by program regulations;
- i. net of applicable credits;
- j. approved in advance if subject to prior approval requirements;
- k. incurred in accordance with competitive purchasing procedures, if required; and
- l. adequately supported by source documentation.

(A copy of the full text of OMB Circular A-87 can be obtained on the internet at <http://www.whitehouse.gov/omb/circulars/index.html>)

The cost of audits done in accordance with the provisions of the Single Audit Act and OMB Circular A-133 (i.e., federal” audits for entities spending more than \$500,000 in federal funds) are allowable as direct or indirect charges to federal grants. Entities not spending \$500,000 in federal funds may not charge audit costs directly or indirectly to federal programs. The OMB Circular A-133 audit costs charged directly to federal programs must be based on the allocation plan found in OMB Circular A-87.

### UNALLOWABLE COSTS

The following costs are unallowable under most federal programs:

- a. Bad Debt Write-offs;
- b. Contributions to a Contingency (Emergency) Reserve;
- c. Entertainment;

- d. Fines and Penalties;
- e. Governor's Expenses;
- f. Interest on Borrowings;
- g. Legislative Expenses (includes any political spending);
- h. Excess of Costs Over the Grant Amount; and
- i. Termination Pay, except for amounts accrued during the grant year (see below).

In addition, credits, such as purchase discounts and price adjustments must be deducted from total costs.

### **TERMINATION PAY**

Federal grants may not be charged directly for termination pay. As provided in OMB Circular A-87, termination pay is an allowable cost if it is allocated as a general administrative expense to all activities of the governmental unit. The U.S. Department of Education prefers termination pay be paid from non-federal funds and included as part of the indirect cost rate calculation. Accordingly, termination pay may either be paid directly from 1) the general, school food, impact aid, the compensated absences (non-teaching staff only) or other appropriate non-federal fund, or 2) may be included in the indirect cost rate calculation.

### **GRANT PERIOD**

Costs must be incurred within the award period to be allowable, unless pre-award costs were specifically authorized in writing by the grantor.

### **DISALLOWANCE OF COSTS**

Unallowable costs charged to a grant program may later be disallowed by an auditor or grantor and may be required to be refunded or withheld from future payments to the grantee.

## **INDIRECT COST (IDC) RECOVERIES**

### **DEFINITION OF INDIRECT COSTS**

An “**indirect cost (IDC)**” is a cost incurred for a common or joint purpose benefiting more than one cost objective, but not readily assignable to the specific programs benefited. The IDCs are “pooled” and charged by allocation to various programs.

An “**indirect cost rate**” is a percentage approved for recovery from state and federal programs. The rate for a public school district must be approved annually by the OPI (see Appendix B for an example of approved rate application).

An “**indirect cost recovery**” is an amount allowed to be charged to a federal grant based on application of an approved IDC rate. The IDC recoveries are “drawn” from a grant award as expenditures are incurred. The amount of a grant award is not affected by IDC recoveries, but the amount of the award available for direct costs of the project is smaller if IDCs are drawn from the award.

### **APPLYING FOR AN INDIRECT COST RATE**

Public school districts who want to recover IDCs from federal or state programs administered by the OPI, or any other agency of the state or federal government, must submit a “Certification and Request for Authorized Indirect Cost Rate” application to the OPI School Budgeting and Account-

ing Division, for approval. An application filed in the spring (usually by March 31) will be the basis for a rate applicable to awards received in the following school year. An application for an IDC rate must be approved before IDCs can be recovered. Rates will not be approved after June 30 of the year of the award (see Appendix B for an example of Indirect Cost Rate Application).

Sub-grantees which are not public schools should contact the federal agency which awards them the greatest amount of federal funds. That agency is the “Federal Cognizant Agent” and is responsible for ensuring the sub-grantee’s overall compliance with indirect cost recovery regulations, including the rate used.

## **INDIRECT COST RATES FOR GRANT AWARDS TO COOPERATIVES/CONSORTIUMS**

The indirect cost (IDC) rate approved for the prime applicant of a consortium may be used by that sub-grantee to claim IDC recoveries when they are allowed.

When an elementary school district and a high school district form a consortium for application for a grant, the district acting as prime applicant for the grant will apply their approved IDC rate when claiming IDC recoveries. For example, if an elementary school district is the prime applicant for the ESEA consolidated application, the elementary district’s approved IDC rate is the rate that will be allowed for IDC recoveries from ESEA programs.

Pass-through entities (i.e., sub-grantees who receive the IDEA grant and transfer it to members of their consortium or cooperative) may not claim any IDC recoveries on pass-through funds.

Special education cooperatives are not authorized to claim Indirect Cost recoveries on OPI-administered programs.

## **SPENDING INDIRECT COST RECOVERIES**

Section 20-9-507, MCA, allows Indirect Cost (IDC) recoveries to be spent at the discretion of the trustees. Accordingly, the school district should adopt a policy addressing how they will spend indirect cost recoveries. The IDC recoveries should be used for general administrative expenses and should not be accumulated beyond the end of the fiscal year unless a spending plan has been approved by the trustees. The IDC recoveries can also be accumulated to a level that is adequate to pay termination payouts (unused vacation and sick leave) for federally paid employees.

## **LIMITS ON THE RECOVERY OF INDIRECT COSTS**

There are five major limitations that affect the amount of indirect costs that may be recovered. These limitations are:

1. APPROVED RATE OR LOWER RATE ALLOWED BY FEDERAL PROGRAM: The rate negotiated with the Office of Public Instruction or federal cognizant agent is the maximum allowable indirect cost for any federal program in which the sub-grantee participates. Federal law or grant conditions may further limit the amount of indirect costs or the indirect cost rate. For example, if the sub-grantee has a restricted rate of 5 percent and the law allows only a 3 percent rate of recovery for that program, then the sub-grantee can only recover indirect costs equal to 3 percent of the direct costs. Some grants may prohibit any recovery of indirect costs.
2. AVAILABILITY OF FUNDS: Recovery of indirect costs on grants is subject to the availability of funds. Most restricted grants are allocated to the state as a block grant in which each

sub-grantee is entitled to a maximum grant amount. The total direct costs plus indirect costs cannot exceed the maximum entitlement.

3. **DIRECT COSTS INCURRED:** Indirect costs are recovered only to the extent of direct costs incurred. The **indirect cost rate is applied to the direct cost amount expended less capital outlay and transfers to other entities**, not to the total grant award.
4. **RATES APPROVED AFTER THE GRANT BEGINS:** Sub-grantees may apply for rates mid-year; however, rates approved midyear may only be applied to expenditures incurred after rate approval. When applying midyear, sub-grantees must submit expenditure totals to date to the appropriate program accountant (listed on page 100-1) to allow the OPI to monitor IDC recoveries after the rate is approved.
5. **PERIOD FOR WHICH RATES ARE APPLICABLE:** An indirect cost rate certification approved by the OPI is applied for one year. The rate is valid from July 1 through June 30 of the applicable fiscal year of approval or the term of the grant award. To recover indirect costs, the LEA applies the indirect cost rate in effect for a given fiscal year or the term of the grant award to the direct expenditures less capital outlay during that fiscal year or the term of the grant award.

#### **USING THE INDIRECT COST RATE**

Once the proposal has been approved by the Office of Public Instruction or federal cognizant agent, the sub-grantee may elect to:

1. Apply the approved and applicable rate to all eligible state and federal projects;
2. Apply the approved and applicable rate only to specific eligible projects; OR
3. Not apply the rate to any projects.
4. Apply the rate approved or less than the rate approved. If the rate applied is less than the rate approved, it is not necessary to apply the reduced rate uniformly to all projects.

#### **BUDGETING FOR INDIRECT COST RECOVERIES**

The following formula determines the amount that may be budgeted for indirect cost recoveries:

$$\begin{array}{lcl} \text{Budgeted} & = & \frac{\text{Approved Indirect Cost Rate \%}}{(1.00 + \text{Indirect Cost Rate \%})} \quad \times \quad \text{Total Award} \\ \text{IDC Recovery} & & \text{less Capital} \\ & & \text{Outlay and Transfers} \end{array}$$

“Capital outlay” includes payments for equipment and facilities acquisition. The IDC recovery cannot be claimed for capital outlay expenditures. Exclude those expenditures from the award amount in calculating the budgeted IDC recoveries.

#### **CALCULATING AND RECORDING ACTUAL INDIRECT COST RECOVERIES**

The IDC recoveries may be taken on actual expenditures incurred, less capital outlay and transfers to other entities.

**Example:**

If actual total direct expenditures less capital outlay are \$10,000 and the IDC rate approved by OPI is 3 percent, a sub-grantee could take “indirects” up to \$300. This amount should be “transferred” from the grant to the “Indirect Cost Recovery” project in the Miscellaneous Programs Fund (15) where it should be spent for administrative and overhead expenses at the discretion of the trustees (20-9-507, MCA).

**INDIRECT COST RECOVERIES SUBJECT TO AUDIT**

The IDC recoveries are subject to audit during the entity’s annual audit. The OPI will also monitor fiscal closeout reports to ensure IDC recoveries were appropriate.

The OPI or any other grantor, including the federal government, may require a recipient to repay IDC recoveries if a recipient draws too much IDC recovery from an award. **Common causes of overdrawn IDC recoveries include:**

1. Using an IDC rate that exceeds the approved rate;
2. Drawing the amount of IDC recovery listed on the project budget instead of applying it to actual expenditures; and
3. Failing to exclude capital outlay and transfers from the actual expenditures used to calculate the amount of IDCs drawn.

## PROCUREMENT

Each sub-recipient should have written policies for the procurement of goods and services. The policies must be based on state and federal laws and regulations on procurement. The major requirements in state and federal laws and regulations are summarized here.

**SCHOOL PURCHASING LAWS**

Schools must follow 20-9-204, MCA regarding bids for all purchases, including purchases using federal and state grant funds. This law requires:

1. Except for district needs that must be met due to an unforeseen emergency as defined in 20-3-322(5), MCA, whenever the estimated cost of any building, furnishing, repairing, or other work for the benefit of the district or purchasing of supplies for the district exceeds the sum of \$25,000, the work done or the purchase made must be by contract.
2. Each contract must be let to the lowest responsible bidder after advertisement for bids.
3. The advertisement must be published in the newspaper that will give notice to the largest number of people of the district as determined by the trustees. The advertisement must be made once each week for two consecutive weeks, and the second publication must be made not less than five days or more than 12 days before consideration of bids.
4. A contract not let pursuant to this section is void.
5. Whenever bidding is required, the trustees shall award the contract to the lowest responsible bidder, except that the trustees may reject all bids.

6. Nothing in this section requires the board of trustees to let a contract for any routine and regularly performed maintenance or repair project or service that can be accomplished by district staff whose regular employment with the school district is related to the routine performance of maintenance for the district.
7. School district trustees may not:
  - a. Have any “pecuniary interest,” either directly or indirectly, in any contract made by the trustee while acting in that official capacity or by the board of trustees of which the trustee is a member; or
  - b. be employed in any capacity by the trustee’s own school district.

“Pecuniary interest” does not include holding an interest of 10 percent or less in a corporation;

“Contract” does not include:

- (i) merchandise sold to the highest bidder at public auctions;
- (ii) investments or deposits in financial institutions that are in the business of loaning or receiving money when the investments or deposits are made on a rotating or ratable basis among financial institutions in the community or when there is only one financial institution in the community; or
- (iii) contracts for professional services, other than salaried services, or for maintenance or repair services or supplies when the services or supplies are not reasonably available from other sources if the interest of any board member and a determination of the lack of availability are entered in the minutes of the board meeting at which the contract is considered.

Section 20-9-205, MCA, prohibits splitting a project or purchase in order to circumvent the bid laws.

## **WRITTEN CODE OF CONDUCT**

All sub-recipients of federal grants must have a written code of standards governing performance of their employees engaged in awards and administration of contracts. The code should:

- Disallow conflicts of interest, real or perceived, from being tolerated.
- Disallow tips or favors from being taken from contractors or potential contractors.

## **FEDERAL REQUIREMENTS FOR PROCUREMENT POLICIES**

Sub-recipient policies for expenditures using federal grants must ensure the entity will:

- Avoid unnecessary purchases and duplications.
- Encourage the most economical purchases (Lease vs. Purchase, etc.).
- Use common goods and services, such as state term contracts, etc., to get the best deals.
- Use federal surplus items in lieu of purchasing additional items.
- Award contracts only to responsible contractors based on such things as organizational integrity, past performance, etc.
- Provide full and open competition, by not: 1) placing unreasonable requirements on firms to qualify to do business; 2) requiring unnecessary bonding or experience from a firm to qualify; 3) allowing noncompetitive pricing between vendors; 4) using retainer contracts; 5) specifying brand names instead of allowing “equal” quality products; or 6) applying any other arbitrary action that unfairly discourages competition.



- Avoid geographical preferences, except those required by state law.
- Identify all qualifying requirements in the request for proposals.
- Include written selection procedures for procurement to ensure clear, accurate description of the technical requirements for a material, product, or service.
- Encourage contracts and awards with minorities.

## **PROCUREMENT RECORDS**

Sub-recipients must maintain procurement records which detail the history of purchasing decisions, including method of procurement and why it was chosen, type of contract used, contractor selection and the basis for it, basis for the contractor's price, etc. (see RECORDS RETENTION in Section 400).

## **RESOLUTION OF DISPUTES**

The grantee and sub-grantee are responsible for resolving contractual disputes. The federal grantor agency will only handle questions of federal law and disputes over protest procedures for failure to review a complaint or process.

## **PURCHASES AND SERVICES USING FEDERAL FUNDS—**

### **TYPE OF PROCESS REQUIRED**

A summary of the type of process to use, depending on the organization and the amount of purchase, is shown below:

Goods/Services Under \$25,000:

All sub-recipients may take proposals from an adequate number of qualified bidders. Informal purchasing policies may be followed.

Goods/Services Over \$25,000:

Sealed bids and formal purchasing procedures, including formal advertising of bid process, are required for all sub-recipients. Preferred method whenever construction is involved, even if not greater than \$25,000.

Federal regulations require the formal purchasing procedures to include:

- Formal advertising;
- Sealed bids;
- Public bid opening process, at time and place advertised in invitation for bids; and
- Written awarding of a fixed price contract to the lowest bidder.

## **REJECTING BIDS**

Under state and federal laws, sub-recipients may reject any or all bids. However, the entity should adequately document the reasons for their actions.

## **NONCOMPETITIVE PROPOSALS**

Noncompetitive proposals are only allowed when the purchase or service is less than \$25,000 for a school district or \$100,000 for an entity other than a school district ; AND sealed bids or competitive proposals are not feasible; AND at least one of the following circumstances applies:

- a) Item is available from a single source;
- b) An emergency situation will not permit a delay resulting from competitive solicitation;
- c) The awarding agency authorizes noncompetitive proposals; or
- d) After solicitation of a number of sources, competition is determined inadequate.